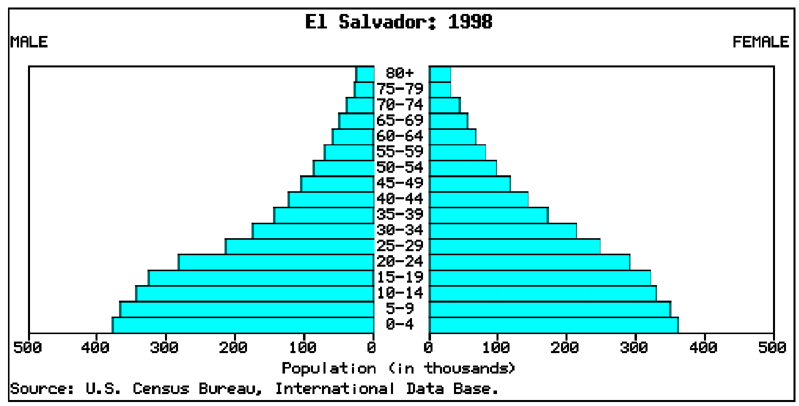
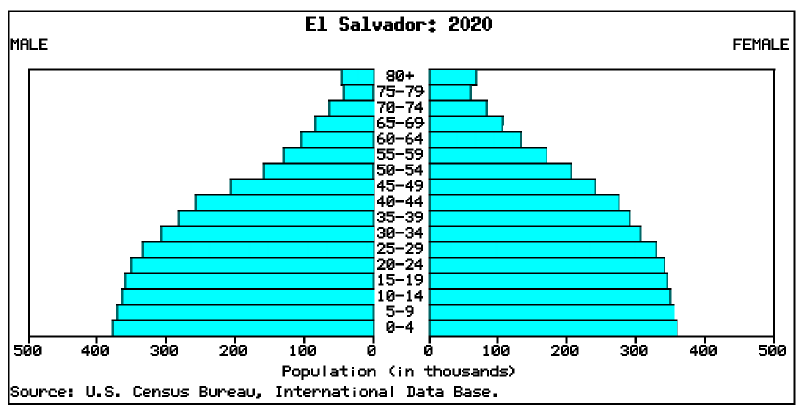
El Salvador

Summary of Current System			
	Pillar 1	**Pillar 2**	**Pillar 3**
Type:	♦ Defined-benefit	♦ Defined-contribution	
Participation:	♦ Mandatory	♦ Mandatory	
Management:	♦ Publicly-managed	♦ Privately-managed	
Financing:	♦ PAYGO	♦ Fully-funded	
Coverage:	♦ Employees in industry, commerce, domestic employees and the self-employed	♦ All workers in private, public and municipal sectors	
Eligibility:	♦ Age 55 for men and 50 for women or 30 years of contribution	♦ Age 60 for men and 55 for women or 30 years of contribution	

Problems Leading to Pension Reform

- ❑ Economic instability
- ❑ Demographic shifts





Summary of Current Pension System

On April 15, 1998, El Salvador implemented the first private pension system in Central America. Pension reform in El Salvador followed the Chilean pension reform model. The new system consists of individual accounts managed by competing private pension fund administrators, or *Instituciones Administradoras de Fondos de Pensiones* (IAFPs). The funds in these accounts will be used to finance old-age, invalidity, and survivors' pensions. The government will guarantee the resources for the payment of minimum pensions. The new system gradually replaces the existing defined-benefit, pay-as-you-go (PAYGO) system, which will eventually be phased out.

All new entrants to the labor market are required to participate in the new system as well as all affiliates of the existing system up to the age of 35. Male workers over the age 55 and female workers over the age 50 must remain in the old system. Workers between these ages will be able to choose whether to transfer to the new system or remain in the old system. Participation by the self-employed will be voluntary. Those who switch over to the new system will receive a "transfer bond" for their past contributions to the old system. The government has established a "transition fund" to provide for transition financing for those switching to the new system.

The retirement age in the new system is 60 years for men and 55 years for women. The government, however, introduced a new provision allowing workers in both systems to retire after 30 years of contribution, regardless of age. The total contribution rate under the old system was 3.5 percent. For those who choose to remain in the old system, contribution rates will increase to 14 percent, with equal contributions from both employers and employees.

As an incentive for workers to switch to the new system, the initial contribution rate was set at 4.5 percent of salaries for the first year with approximately 3.0 percent contributed by employers and 1.5 percent by employees. The contribution rate

SELECTED INDICATORS		
	Year	
Demographic	*1998*	*2020*
Total Population (in thousands)	5,752	7,852
Life Expectancy at Birth (Years)	69.7	76.6
Total Fertility Rate (Child Born per Woman)	3.1	2.3
Age Dependency Ratio (percent)	13.2	16
	1980-2000	*2000-2020*
Average Annual Rate of Population Growth (percent)	1.4	1.4

Source: U.S. Bureau of the Census. International Data Base.

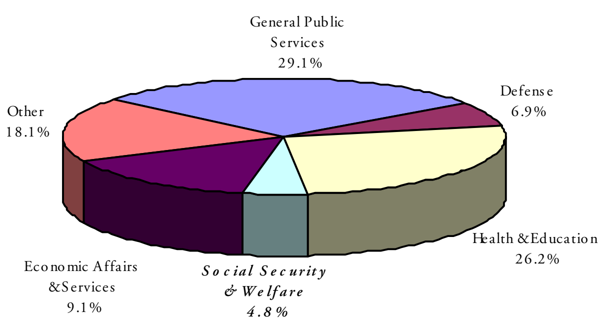
Economic	*1996*
GNP (PPP in billions)[1]	16.2
GNP Average Annual Growth Rate, 1995-1996 (percent)[1]	2.6
GNP Per Capita (in PPP)[1]	2,790
Inflation Rate (percent)[2]	9.8
Labor Force Participation Rate (percent)[3]	41.7
Unemployment Rate (percent)[3]	7.7

Source: [1]World Bank; [2]IMF; [3]International Labour Office.

Pension	*1997*
System Dependency Ratio, 1996 (percent)[1]	11.6
Employee Contribution for Pensions (percent of earnings)[2]	Varies
Employer Contribution for Pensions (percent of payroll)[2]	Varies
Public Pension Spending as % of Government Spending	n/a
Public Pension Spending as % of GDP (percent)	n/a

Source: [1]Cifuentes and Larraín (1998); [2]U.S. Social Security Administration.

GOVERNMENT SPENDING BY SECTOR, 1996



Source: International Monetary Fund. Government Finance Statistics Yearbook, 1997.

in the new system will gradually increase to 10 percent by 2002, with approximately two-thirds contributed by employers and one-third by employees. Workers also pay an insurance premium to cover the disability and survivor benefits along with an administration fee charged by IAFPs. Separate contributions for sickness, maternity, and work injury benefits will also continue to be collected. Workers are allowed to make additional voluntary contributions to their private pension account. In addition, they may switch between IAFPs every six months.

Upon retirement, workers participating in the private system will collect pension benefits based on their individual contributions plus accrued interest. These workers will have the choice of a programmed withdrawal of funds, an annuity, or a combination of the two.

The government had approved five IAFPs by May 1998. The new private pension system is expected to attract 400,000 participants and as much as $2 billion into the local capital markets over the next 10 years.

Problems That Led to Pension Reform

After the civil war that ended in 1992, El Salvador experienced rapid economic growth. From 1992 to 1995, the country's economy has grown five percent each year. In the same period, the inflation rate declined from 11.2 percent to 8.0 percent. In an effort to sustain economic growth, the government identified areas to reform, including education reform, electricity and telecommunications deregulation, government modernization and pension system reform. Thus, pension reform in El Salvador was motivated by an overall plan to reform and modernize the country.

El Salvador's Pension Reform Law was passed in December 1996, which created a dual public-private pension system. In mid-1997, El Salvador experienced a severe economic crisis and the climate was deemed unfavorable for the introduction of a new pension system. There was also little interest on the part of foreign investors to participate in the new system. Implementation of the private pension system subsequently occurred in 1998.

Challenges Facing Reformed System

The economic downturn in 1996 underscored the constraints facing the El Salvadoran economy. Compared to other Latin American countries that have undergone pension reform, El Salvador is a much smaller market for investment opportunities. International investors however are expecting that other Central American countries will follow El Salvador's lead in establishing private pension systems, which will result in increased market presence in the region. The limited depth of the capital markets in El Salvador may nonetheless pose a great challenge to the new private pension system.

Pension Reform Efforts by Pillar

	Pillar 1	Pillar 2	Pillar 3
Papers issued on state of pension systems	✓	✓	
Formulation of proposals	✓	✓	
Development of draft legislation	✓	✓	
Introduction of legislation by parliament	✓	✓	
Review of legislation by parliament	✓	✓	
Passage of legislation by parliament	✓	✓	
Implementation of legislation	✓	✓	